

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

GEORGE A. DAVID, SR., et al.	:	CIVIL ACTION
	:	
v.	:	
	:	
L.A. PRESIDENTIAL MANAGEMENT	:	
II, L.P., et al.	:	No. 98-6556

MEMORANDUM

Ludwig, J.

August 22, 2000

Defendants Winding Way Management, L.A. Presidential, L.A. Presidential Management, L & A Management Inc., Dean S. Adler and Ira Lubert move for summary judgment. Fed. R. Civ. P. 56.¹ Jurisdiction is federal question and supplemental. 28 U.S.C. §§ 1331, 1367.

I. Background²

Plaintiffs are George A. David, Sr., Robert Turk and Patricia A. Murray, members of Presidential Associates L.P., a limited partnership, which operated a complex known as "The Presidential" located on City Line Avenue, in Philadelphia. The complex consists of five high-rise apartment buildings, the Madison, Washington, Adams, Jefferson and the Monroe. Presidential Associates owned the first four, and the Monroe was owned by David individually.³ The first

¹ "[S]ummary judgment should be granted if, after drawing all reasonable inferences from the underlying facts in the light most favorable to the non-moving party, the court concludes that there is no genuine issue of material fact to be resolved at trial and the moving party is entitled to judgment as a matter of law." Becton Dickinson and Co. v. Wolckenhauer, 215 F.3d 340, 343 (3d Cir. 2000) citing, Kornegay v. Cottingham, 120 F.3d 392, 395 (3d Cir. 1997).

² The background facts are taken largely from plaintiffs' response to the summary judgment motion. The response contains deposition and trial citations, which are omitted here.

³ George David, a real estate developer, is the principal plaintiff. The apartment buildings also had related commercial uses.

four buildings were subject to a mortgage in favor of Heller Financial, Inc. The Monroe was subject to two separate mortgages, and David and his wife were the obligors.

On June 13, 1996, Heller filed a mortgage foreclosure action against Presidential Associates in this court. Presidential Associates responded with a counterclaim, and on July 31, 1996, the limited partnership was placed into receivership.

In February, 1997, George David, representing Presidential Associates, and John Kay, of Kay Properties, Inc., met to discuss the possible sale of the Presidential Complex as an alternative to the foreclosure. The proposal was that Kay would obtain financing to buy the Heller mortgage, settle the litigation, and create another limited partnership to own and operate the properties, including the Madison. Kay/David proposal, exh. 21.

For these purposes, Kay retained the Philadelphia law firm of Klehr Harrison Harvey Branzburg & Ellers, which, in turn, introduced him to Ira Lubert and Dean S. Adler, the principals of the Lubert-Adler fund.⁴ On May 1, 1997, Kay agreed to forego purchasing the Heller mortgage in favor of Lubert-Adler. Kay/Lubert-Adler agreement, exh. 22. At this time, Heller informed David that a third-party, other than Kay, had become interested in the mortgage.

On June 2, 1997, the Lubert-Adler Fund gave Heller a letter of intent to obtain an assignment of the note and mortgage for \$27.65 million and to indemnify Heller with respect to Presidential Associates's counterclaim.

⁴ Klehr Harrison also represented Heller Financial and now represents defendants.

On July 18, 1997, after a series of contentious negotiations, Lubert-Adler and David agreed to form a new limited partnership, LAD II, to purchase the Madison from plaintiffs.⁵ The Madison would be managed by David, and Lubert-Adler would fund substantial renovations.⁶ On September 15, 1997, the parties closed on the transaction.⁷ Lubert-Adler received an 88 percent interest in LAD II and plaintiffs the remaining 12 percent.⁸

Prior to the foreclosure, David had been in the process of converting the Madison into a senior living facility; and, as part of the formation of LAD II, the parties agreed to evaluate various potential uses for the Madison, including a senior living facility and a hotel. In the meantime, the conversion into a senior living facility was to proceed, with David continuing to manage the property. Once a final use was determined, David would be replaced by a third-party operator.

In April, 1998, Lubert-Adler decided that a mixed-use, with both a hotel and senior-living accommodations, would be the best use, and they designated a new operator for the property. David, however, disagreed; he wanted

⁵ The substance of the agreement was reflected in a "Term Sheet" executed by the parties that day.

⁶ According to Lubert-Adler their the total acquisition and renovation costs for the Madison were to be \$12 million – which to them represented its fair market value at that time. Plaintiffs assert that the fair market value was at least \$12,312,952, and perhaps as much as \$19 million.

⁷ The closing documents included: (1) the master agreement, (2) the LAD II partnership agreement, (3) the management agreement, and (4) the settlement and release.

⁸ According to plaintiffs, the partnership agreement gave them an option to increase their limited partnership interest to 37 percent. This option was not exercised.

a single-use senior living facility with himself as permanent operator. Unable to resolve their disputes, the parties agreed to dissolve their relationship.

On June 11, 1998, the parties entered into a written restructuring agreement that included giving David a six-month option to purchase Lubert-Adler's 88 percent interest in LAD II for \$8,875,000. LAD II's sole asset was the Madison real estate. In exchange, David agreed to relinquish control of the Madison if the option was not exercised.

The option afforded David the opportunity to sell or re-acquire the property for the amount of Lubert-Adler's investment. However, David was unable to do so within the six-month time period, and the option, by its terms, was terminated. David, thereupon, declined to give up operational control of the Madison. On December 16, 1998, plaintiffs filed the present action, claiming a violation of the Securities Exchange Act, together with numerous state law claims of fraud and misrepresentation.

II. The Trial on Damages: The Madison's Value as a Senior Living Facility

On the eve of the trial, a settlement was discussed in which defendants would purchase plaintiffs' 12 percent interest in LAD II. The parties recognized that a working relationship was no longer feasible, and that regardless of the disposition of this case, plaintiffs would retain their 12 percent ownership. A buyout by Lubert-Adler therefore appeared to make the most sense. However, the value of the Madison was in dispute. Plaintiffs' position was that if the conversion to a senior living facility were completed, the Madison's value would be much greater than it was in its present condition or for some other use. Defendants contended that to continue the conversion would decrease the

property's value, not enhance it. The valuation issue was focused, therefore, on what was the highest and best use of the property. While the monetary amount would not be determinative of the value of the limited partnership, it was an essential element in the calculation of that figure. Moreover, from plaintiffs' standpoint, an award of damages for the loss of their bargain would necessarily be related to the value of the Madison as a completed senior citizen facility.

Accordingly, to obtain a partial determination of the damages issue that could also assist the parties in reaching a resolution, the trial was bifurcated and a single damages question was submitted to the jury. "If the Madison were fully converted to a senior citizen facility, what would the value be in year 4 when the conversion was completed?"⁹ After six days of trial, the jury returned a valuation of \$ 12,100,000. Plaintiffs had asked the jury for a verdict of \$ 26,000,000; defendants had argued for a range between \$12,500,000 and 14,700,000. Following further unsuccessful attempts at settlement, defendants moved for summary judgment.¹⁰

III. The Effect of the Jury Verdict

Defendants' theory is that, given the \$ 12,100,000 market value fixed by the jury verdict, a compensable fraud or breach of contract injury cannot be

⁹ It was agreed that it would have taken four years from the inception of LAD II, or until September of 2001, to complete the conversion.

¹⁰ On February 8, 2000, plaintiffs' motion to declare the jury verdict non-binding and advisory was denied, order, February 25, 2000, and reconsideration was denied, order, March 10, 2000. The legal effect of the jury verdict was to determine the question of what loss, if any, was sustained by plaintiffs, assuming that they were entitled to have the property converted to a senior living facility. All of the due process procedures of a jury trial were followed, and the trial did not proceed on the basis that it was merely advisory.

demonstrated. The merit of that conclusion depends on whether the \$ 12,100,000 after adjustments and reduction to present value as of November 22, 1999 is equal to or less than the value of the Madison on that date. In support of their motion, defendants have submitted the affidavit of defendant Dean S. Adler, who has the credentials of a qualified expert in the field of real estate investing. The affidavit states that the present value of the jury verdict "is no higher than \$10 million, and because the total debt and equity on the Madison is \$12 million, there would be nothing to distribute to plaintiffs. . . ." Adler aff. at ¶ 9. Plaintiffs' response is not materially different. David's affidavit is that the present value of the jury verdict "may be as high as \$10,900,000.00" David aff. at ¶ 6.

Other economic factors, such as the cost of completing the conversion and the amount of the carrying charges until completion, were not presented to the jury. Neither was a calculation of the value of plaintiffs' 12 percent in LAD II under the limited partnership agreement.¹¹ Nevertheless, upon analysis, the jury verdict is dispositive. Considering both the present value of the jury verdict as of the date it was rendered and the fair market value of the property on that date, plaintiffs are unable to show a compensable injury arising from their supplemental claims.

¹¹ In his affidavit, David states that because the total equity required for his plan was considerably less than defendants' figure, plaintiffs' interest, assuming their exercise of the option to purchase an additional 25 percent of the partnership, would have been worth \$950,000. David aff. at ¶ 6. This unsupported argument is not enough to present a triable issue under Rule 56. Under the LAD II Term Sheet, Lubert-Adler is entitled to distribution of \$7 million in debt and up to \$5 million in equity before plaintiffs receive any payment. The general partner is L.A. Presidential Management II, L.P., managed by Dean S. Adler.

The two legally significant valuation figures are the jury verdict reduced to present worth and the value of the Madison, both as of the date of the verdict, November 22, 1999. If the present value of the verdict, (representing the Madison's value assuming the David plan were carried out) exceeded its fair market value on the date of the verdict, there is a compensable injury; otherwise, there is not.

Here, taking plaintiffs' present value figure of \$10,900,000, the present value of the verdict is substantially less than the fair market value of the Madison on November 22, 1999. Plaintiffs' position is that the value of the Madison in September 1997, when it was sold to LAD II, was between \$12,312,952 and 19,000,000. David aff. at ¶ 3.

Accordingly, since plaintiffs have not produced evidence of a genuine issue of fact as to a compensable injury, the supplemental state law claims must be dismissed.¹² Since damages are determined differently for violations of Rule 10b-5, this count will be considered separately.¹³

¹² For actions based on fraud or negligent misrepresentation, "the measure of damages is 'actual loss,' and not the benefit, or value, of that bargain." Delahanty v. First Pennsylvania Bank, NA, 318 Pa. Super. 90, 108, 464 A.2d 1243, 1252 (1983) (citations omitted). This does not change the result.

¹³ "The usual measure of damages for securities fraud claims under Rule 10b-5 is out-of-pocket loss; that is, the difference between the value of what plaintiff gave up and the value of what plaintiff received." Ambassador Hotel Co. v. Wei-Chuan Investment, 189 F.3d 1017, 1030 (9th Cir. 1999); see also Rochez Bros., Inc. v. Rhoades, 491 F.2d 402, 411 (3d Cir. 1974). The purpose of this act "is to give a defrauded seller the benefit of whatever measure of damages provides the greater recovery: either the difference between the sale price of the stock in the fraudulent transaction and its fair market value at that time or the amount of the fraudulent buyer's profit on resale." Rochez Bros., 491 F.2d at 417.

IV. The 10b-5 Claim

The complaint also alleges that defendants' misrepresentations relative to the LAD II limited partnership amount to a § 10b-5 violation. 15 U.S.C. 78j(b) and 17 C.F.R. § 240.10b-5. A § 10b-5 violation requires proof –

that the defendant (1) made a misstatement or an omission of a material fact (2) with scienter (3) in connection with the purchase or the sale of a security (4) upon which the plaintiff reasonably relied and (5) that the plaintiff's reliance was the proximate cause of his or her injury.

Semerkeno v. Cendant Corp., Civ. Nos. 99-5355 & 99-5356, 2000 WL 1131928 at *6 (3d Cir. June 16, 2000).

It is basic that there be a purchase or sale of a security. An interest in a limited partnership can be a "security" under the Securities Exchange Act if "a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." SEC v. W. J. Howey Co., 328 U.S. 293, 299, 66 S.Ct. 1100, 1103, 90 L. Ed. 1244 (1946); Steinhardt Group, Inc. v. Citicorp, 126 F.3d 144, 152 (3d Cir. 1997).

Here, the first two parts of the Howey test are present – the investment of money in a common enterprise. However, David was intimately involved in the day-to-day operations of the Madison, so that plaintiffs cannot be said to have expected to profit solely from the efforts of others – the third requirement. See Gubitosi v. Zegeye, M.D., 28 F. Supp. 2d 298, 303 (E.D. Pa. 1998) (limited partnership interest was a security because "plaintiffs did nothing with respect to the operation of [the partnership] other than invest money . . ."); Frazier v. Manson, 484 F. Supp. 449, 452 (N.D. Tex. 1980) (limited partnership

was not a security because plaintiff "participate[d] actively in the daily business operations of . . . the limited partnerships."). David, as plaintiffs' representative, participated in all major decisions and managed the property for a year following the creation of the limited partnership. As limited partners, plaintiffs, including David, intended to profit from his efforts as well as the efforts of defendants. So viewed, their limited partnership interest can not qualify as a security under the Act, for which reason the § 10b-5 claim must be dismissed.

V. Conclusion

Defendants' motion for summary judgment will be granted. The federal question claim is untenable as a matter of law, and in light of the jury verdict on damages, there is no triable issue as to plaintiffs' supplemental claims.

Edmund V. Ludwig, J.

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ORDER

AND NOW, this 22nd day of August, 2000, defendants' motion for summary judgment is granted and this action is dismissed.

Edmund V. Ludwig, J.